

Executive Director Update
December 7, 2011

June 30, 2011 Actuarial Status for ATRS
Generally Good News

The annual ATRS actuarial valuation conducted by Gabriel Roeder Smith & Company for June 30, 2011, is now available in preliminary form. The valuation has both positives and negatives. On balance, the position of ATRS is better than most people thought it would be at the beginning of the fiscal year. ATRS is also in a much stronger position than many retirement systems around the country. ATRS remains financially strong. The 2011 ATRS actuarial valuation includes four year smoothing of gains and losses in the trust fund and other assumptions to reach the result. The bottom line result for June 30, 2011: ATRS has a **66 year amortization period** with a **funded ratio of 72%**. If the four-year smoothing were removed, (real deal current numbers), then ATRS would have an amortization period of just **34 years** and be **77% funded**. The time-delayed actuarial valuation actually paints a bleaker result than the actual unsmoothed current numbers for ATRS.

The positive aspects to the report are important:

First, ATRS has now absorbed the most recent experience study conducted this past summer into this valuation. The new experience study added significant new liabilities due to longer life expectancy for members. Members living longer is a good thing!

Second, ATRS currently uses only about **2%** of the trust fund per year to pay member benefits. This means almost the entire value of the trust fund is being held to pay benefits well into the future. ATRS has many years to make necessary adjustments and investments to maintain the strength of the fund. Only needing about 2% annually further illustrates the overall strength of the ATRS trust fund.

Third, ATRS has reduced its **actual** "unsmoothed" unfunded liabilities by about \$1.1 billion dollars in the last fiscal year. On June 30, 2010, the unsmoothed unfunded liabilities were about **\$4.8** billion dollars. The unsmoothed unfunded liabilities for June 30, 2011, are about **\$3.7** billion dollars. This equals a reduction of about \$1.1 billion dollars in one year when smoothing is removed to reveal actual circumstances.

Fourth, for the first time in a few years, the actuarial value of the trust fund will actually be **lower** than the real trust fund value due to the smoothing in of the gains in the future from the last two positive years. This means the fund has more money in it than the study used to determine the fund's status and amortization period.

Fifth, due to actuarial standards, most of the cost-savings acts from both the 2009 and 2011 legislative sessions are not reflected in the actuarial valuation since actuaries are limited in their ability to reflect savings into a valuation unless very specific criteria are

met (a change in an assumption can be reflected). Only **one** cost-savings act from 2011 was used by the actuaries to reduce the unfunded liabilities. This means that the bulk of the cost savings will show up over time in annual gain/loss studies rather than being reflected in the immediate actuarial report. Over time, as these gains are recognized by reduced costs, it will be reflected in a reduction of the amortization period annually as the savings occur. This is like weatherizing a home. You know that new insulation in the walls, new insulation in the attic, caulking, new windows and doors, energy saving appliances, floor insulation, and the like will reduce energy consumption, but you do not get the benefit of the reduction in your home's "energy rating" until the specifics show up on your utility bills over time. On the ATRS costs savings, ATRS gets no benefit on the bulk of the savings enacted until it shows up over several years in annual results.

At the same time that the positives should be considered, the unsteady markets thus far in the current fiscal year mean that ATRS needs to regain from a loss of approximately \$800 million dollars since June 30, 2011, and add approximately another \$800 million dollars on top of that to obtain an 8% return for the fiscal year. If the economic uncertainty is addressed in a positive manner, then that result can still be reached in the next seven months. If not, ATRS will have to address the final result.

Comparisons for June 30, 2010 and June 30, 2011 with Smoothing:

	2010	2011
Accrued Liabilities	\$3.8 billion	\$4.3 billion
Percent Funded	74%	72%
Amortization Years	52 years	66 years

Comparisons for June 30, 2010 and June 30, 2011 without Smoothing:

	2010	2011	Difference
Accrued Liabilities	\$4.8 billion	\$3.7 billion	(\$1.1 billion)
Percent Funded	67% funded	77% funded	10%
Amortization Years	>100 years	34 years	66+ years

Another Way to Summarize the Results

To try to simplify the sometimes confusing language of actuaries and actuarial studies, the following is a summary of the media question and the full ATRS response sent to answer a media inquiry about the June 30, 2011, ATRS actuarial status:

Question:

Is there is an understandable way to explain to a lay person the system's increase in unfunded liabilities as of June 30, 2011, compared to a year earlier? The actuaries sometimes talk in confusing language when they breakdown the sources of the increase in liabilities. A lay person might say it's the result of the system's losses outstripping gains over a four-year period and members living longer. Do you have a better way of explaining it?

Response:

Part of the confusion relates to how actuaries report information coupled with the four-year smoothing process. If I were asked to explain why the ATRS amortization period increased despite ATRS having an investment return of over 22% in the fiscal year along with significant cost cutting legislation that will be realized in the future, I would explain it as follows:

- 1. The latest ATRS experience study materially increased the projected future liabilities of ATRS due to members living longer and receiving benefits for more years than a retired member would have received under the previous life expectancy assumption.*
- 2. Through four-year smoothing, ATRS is having to realize more losses in 2011 from 2008 and 2009 than the gains that can currently be realized from 2010 and 2011.*
- 3. The vast majority and largest percentage of ATRS cost savings legislation from the 2009 and 2011 legislative sessions are not projected into the future as savings of the plan but will be incrementally realized after the fact, annually, through a gain-loss study performed by the actuaries each year. This requirement is based upon actuarial standards. An analogy, if a home owner refinances their mortgage and obtains a lower interest rate, their house payment may be \$300 less per month in the future for the life of the loan. If that same person made improvements to the home to reduce utility bills by \$300 per month, that same \$300 reduction would **not** be used from a bank's standpoint as a savings when determining eligibility for a car loan.*

4. *At times, actuarial smoothing over a four-year period provides a brighter or darker view than the real status of a retirement system. The current actuarial valuation provides a **darker** view due to two years of quality returns by ATRS being realized in the future. The real view of ATRS, **without smoothing**, is a 34 year amortization period and unfunded liabilities of \$3.7 billion dollars which is down \$1.1 billion dollars from the **unsmoothed** \$4.8 billion dollars in real unfunded liabilities for June 30, 2010.*
5. *Most of the additional liabilities to ATRS, such as members living longer, were projected into the future view of the plan, but cost reductions were not factored in at all. The four-year smoothing made ATRS appear being worth approximately \$11.1 billion dollars on June 30, 2011, when its real value was approximately \$11.8 billion dollars.*

In summary, the increase in liabilities can be summarized by additional liabilities due to members living longer, the net gains by ATRS over losses that exist not being factored into the ATRS value due to four-year smoothing, and the bulk of cost savings from the past two legislative session being incrementally absorbed after the fact instead of the substantial savings being projected as a cost savings into future years.

The ATRS Board of Trustees and staff remain committed to closely monitor all of these moving parts and valuation issues to make appropriate decisions, as need be, in the future.

T-DROP Cash Balance Account ATRS Board of Trustees Continues Quality Options

The ATRS Board has instructed ATRS staff to continue to find more and better ways to serve members. The latest ATRS Board of Trustees' initiative is to work to develop an ATRS cash balance account for members exiting T-DROP, much like rolling a T-DROP distribution amount to another plan administrator. An ATRS cash balance account would allow members to leave their T-DROP balance at ATRS in an interest- bearing account with competitive interest rates, backed by the financial stability of the ATRS trust fund.

ATRS staff is working with the ATRS tax attorney to develop a draft rule to carry out this initiative. Because this is a cash-balance account, withdrawals from the account would be possible in a time and manner as prescribed by the ATRS Board of Trustees. This type of account was discussed by the ATRS Board of Trustees in its December 5, 2011, meeting. The ATRS Board of Trustees expressed strong interest in developing all of the rules necessary to implement this plan while seeking additional member and legislative input. ATRS staff is busy developing a draft rule that could be implemented by the ATRS Board of Trustees as early as July 1, 2012, pending all required legal due diligence and public input.

If this proposal is adopted, T-DROP members will be able to choose one of the following distribution options and still leave their T-DROP balance at ATRS:

1. Annuitize the T-DROP balance as an additional monthly benefit payment;
2. Leave the balance in an ATRS interest-bearing cash-balance account;
3. A combination of #1 and #2.

The other existing options for members would be unaffected by this change. Members would maintain the right to immediate payment of the balance and the right to roll all or part of the T-DROP balance to another plan administrator.

Reminder of the Upcoming Regional Meeting of the Joint Committee on Public Retirement of the Arkansas General Assembly

The next regional meeting of the Public Retirement Committee will be held in Jonesboro on December 12 and 13, 2011. The main opportunity for public comment will be the December 12 meeting. The Public Retirement Committee has undertaken regional meetings throughout the state to hear from the public and members of the various retirement systems for input concerning the retirement plans and any issues of concern. The third in the series of regional meetings of the Public Retirement Committee is scheduled in Jonesboro as follows:

**December 12, 2011
4:30 – 6:30 p.m.**

**ASU Fowler Center – Riceland Hall
201 Olympic Drive
Jonesboro, AR**

**December 13, 2011
9:30 – 11:30 a.m.**

**Hilton Garden Inn
2707 Fair Park Blvd
Jonesboro, AR**